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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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In the Matter of	
Access Charge Reform	CC Docket No. 96-262
Price Cap Performance Review for Local Exchange Carriers	CC Docket No. 94-1

REPLY COMMENTS OF BELL ATLANTIC

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I. Introduction and Summary.

All sectors of the industry oppose the proposal to require capacity-based rates for local switching. The Commission should not force this rate structure on carriers that do not need it or want it. In addition, the comments demonstrate that local switching costs are traffic-sensitive, and that adoption of capacity-based rates would not change this fact. Because local switching costs are traffic-sensitive, there is no basis for either a retroactive or prospective change in the local switching price cap formula that would deny local exchange carriers the benefit of demand growth for local switching.

The comments demonstrate that the best way to deal with the issues of rate structure and rate level in the local switching category is to adopt the CALLS access

[1] The Bell Atlantic telephone companies ("Bell Atlantic") are Bell Atlantic-Delaware, Inc.; Bell Atlantic-Maryland, Inc.; Bell Atlantic-New Jersey, Inc.; Bell Atlantic-Pennsylvania, Inc.; Bell Atlantic-Virginia, Inc.; Bell Atlantic-Washington, DC, Inc.; Bell Atlantic-West Virginia, Inc.; New York Telephone Company and New England Telephone and Telegraph Company.

reform proposal. ***See, e.g.,*** AT&T, 2; Sprint, 5-6, 10-11; GTE, 2. The CALLS proposal would reduce local switching rates, move some cost recovery from local switching to common line, provide a framework for geographic deaveraging of common line rates, and accomplish other access reform and universal service goals.

The Commission should stay the course on its market-based approach to access charge reform by completing its framework for pricing flexibility and by adopting market-based controls to deal with excessive access charges imposed by competitive local exchange carriers.

II. No Segment Of The Industry Wants The Commission To Require Capacity-Based Charges For Local Switching.

All carriers -- incumbent local exchange carriers, competitive local exchange carriers, and interexchange carriers – uniformly oppose the proposal to require capacity-based rates for local switching. ***See, e.g.***, USTA, 10-15; US West, 8-15; AT&T, 12-16; MCI WorldCom, 10-12; Sprint, 10-13; CompTel, 5-7; ALTS, 30-33. This alone should convince the Commission not to go forward with this proposal. When both the providers of a service and the purchasers of that service are satisfied with the current rate structure and firmly oppose a change, there is no need for the Commission to intervene with a radically different structure that would disrupt their business relationships.

The carriers agree that the costs remaining in the local switching category are traffic sensitive and that it is economic to recover these costs on a per-minute basis. ***See, e.g.***, AT&T, 12-13; USTA, 12-13 & Attachment A, 7-8. Indeed, the purported justification for a capacity-based rate structure is that it would more accurately reflect peak period minutes-of-use, which is the primary driver of switch capacity.[2] However, the carriers point out that interexchange carrier demand is only about 15 percent of total traffic, and that the peak period for interexchange traffic may not coincide with the peak period for all traffic handled by a switch. ***See, e.g.***, US West, 14-15; GTE, 30-31. Consequently, the amount of trunk capacity ordered by interexchange carriers is a poor measure of peak capacity, and adopting a capacity-based rate structure is not more economically efficient than the current minute-of-use rate structure.

Moreover, the record clearly demonstrates that requiring a shift to such a rate structure would be administratively expensive and operationally disruptive. Carriers would have to modify their billing systems, and interexchange carriers would be compelled to engage in yet another round of network reconfigurations. ***See, e.g.***, MCI, 11; Sprint, 12; CompTel, 6-7. The carriers agree that this rate structure would not result in any incremental benefit, but the immediate costs of shifting to a new structure are real. The Commission should not impose an expensive solution to a non-existent problem.

The only commenters who support capacity-based rates for local switching are Ad Hoc and GSA, who hope to see some benefit, as end users, from the change. ***See*** Ad Hoc, 9-15; GSA, 9-10. However, the interexchange carriers' comments demonstrate that these hopes are in vain, because there would be no benefits to pass along to end users. They explain (and correctly so) that a capacity-based rate structure is not likely to result in any consumer benefits, and that any such benefits would be outweighed by the

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[2] ***See*** In the Matter of Access Charge Reform, CC Docket No. 96-262, Fifth Report and Order and Further Notice of Proposed Rulemaking, FCC 99-206 (rel. Aug. 27, 1999) ("Order" or "Further Notice"), ¶ 211.

increased administrative and reconfiguration costs. ***See*** MCI, 9-12; AT&T, 15; Sprint, 12-13. The interexchange carriers are also concerned that they might end up paying *more* for switching capacity under a flat-rated structure than they do under the current per-minute rates. ***See, e.g.***, AT&T, 16. Inevitably, a rate structure that increases the costs of access would be passed along to consumers in the form of higher long distance rates. Indeed, the interexchange carriers have not hesitated to increase their rates when their underlying costs have increased. ***See, e.g.,*** Interexchange Carrier End-User Charges To Recover Universal Service Contributions, AT&T Tariff FCC Nos. 13 and 27, Transmittal No. 11460, CC Docket No. 99-324, Suspension Order (rel. Nov. 1, 1999).

For these reasons, the Commission should not mandate a capacity-based rate structure for local switching. The best way to deal with both rate structure and rate level issues in the traffic-sensitive basket is to provide the incumbent local exchange carriers the flexibility to adopt alternative local switching rate structures that meet the requirements of a competitive market and to adopt the CALLS proposal, which would shift additional costs out of local switching and reduce switched access rates throughout the country by 50 percent. ***See*** Comments of the Coalition for Affordable Local and Long Distance Service ("CALLS") (filed Nov. 12, 1999). The CALLS proposal would meet the needs of both local and long distance carriers for a predictable access environment that moves implicit subsidies out of access charges and simplifies the rate structure for recovery of loop costs. As AT&T notes (at 2), the CALLS proposal "would resolve, in an equitable and sustainable manner, virtually all" of the local switching issues in the Further Notice.

III. There Is No Basis In The Record For A Reduction In Access Charges.

Despite the industry consensus that capacity-based rates for local switching are not economically justified, AT&T and MCI could not resist supporting yet another "one-time" reduction in access charges through the introduction of a "q" factor in the traffic-sensitive price cap formula.[3] However, their recognition that there is no economic basis for a capacity-based rate structure eviscerates any supposed theory for imposing either a prospective or a retroactive reduction in the traffic-sensitive price cap index. Their arguments for imposing drastic reductions in access charges are completely irrelevant to the issues raised in the Further Notice, and they are flatly contradicted by their own concessions about the traffic-sensitive nature of local switching costs.

AT&T argues that a "q" factor should be introduced to remove the effect of the growth in local switching minutes from the price cap formula, based on its argument that the costs of switching "tend not to increase with growth in traffic." AT&T, 18. Yet, in the same pleading, AT&T concedes that "the current [usage-based] rate structure for local switching is reasonably cost-based" and that "the amount of switching capacity required depends on overall traffic during the LEC's peak period." Id., 12, 15. AT&T's claims also are flatly contradicted by arguments that both MCI and AT&T presented in the Commission's universal service cost proxy model proceeding, where they proposed a costing module that tied switch costs directly to the volume of traffic that could be

[3] ***See*** AT&T, 17-20; MCI Worldcom, 12-15. However, AT&T notes that the CALLS proposal would obviate the need for the prospective rate adjustments proposed in the Further Notice. ***See*** AT&T, 2.

handled by the switch processor. ***See*** HAI Model Release 5.0a, Model Description (rel. Feb. 16, 1998), § 6.5.3.1; Inputs Portfolio (rel. Jan. 27, 1998), § 4.1.

Not only do AT&T's own concessions refute its newly-minted claims that switching capacity is essentially limitless, and therefore costless, but they are further refuted in the analysis attached to USTA's reply comments. ***See*** USTA Reply Comments, Comments of Delidow & Parsons. This analysis demonstrates yet again that switching costs are usage sensitive, because the switching matrix has a limited capacity, and that the costs of this portion of the switch therefore vary directly with traffic volume.

AT&T, nevertheless, claims that local switching costs do not increase with traffic volume, arguing that the local exchange carriers' interstate expenses and investments have declined since price caps while local switching minutes have grown by 66 percent. ***See*** AT&T, 18, Attachments A & B. However, these data merely illustrate the fallacy of relying on interstate accounting data to reach economic conclusions. Costs are allocated between state and interstate jurisdictions based on arbitrary separations rules and by relative changes in demand between state and interstate. In particular, the allocation of expenses and investments to the interstate local switching category has been reduced significantly by such factors as (1) the phase-in to pure dial equipment minutes as the allocator of investment for local switching, which reduced the assignment of investment to the interstate jurisdiction; (2) the 1993 shift of a significant portion of general support facilities investment from local switching to common line; (3) the 1998 shift of line port investment from local switching to common line;[4] and (4) the increase in dial equipment minutes associated with calls to the Internet, which the Commission has assigned to the local exchange carriers' intrastate accounts. These changes make any examination of interstate costs meaningless for purposes of identifying the relationship between switching costs and demand growth.

Stripped of any cost justification, the arguments of MCI and AT&T for an opportunistic reduction in access charges are reduced to complaints about the price cap system itself. AT&T argues (at 18) that the interexchange carriers "deserve" the benefit of revenue growth in local switching, since they claim responsibility for interstate demand growth. However, as is explained in Dr. Taylor's analysis, (1) there is no basis in economics for the notion that a party that influences output growth of another producer is "entitled" to the associated earnings; and (2) the interexchange carriers cannot claim credit for the growth in local switching volumes, which can be explained entirely by the effect on long distance prices of local exchange carrier access charge reductions. ***See*** USTA Reply Comments, Reply Comments of Dr. Taylor.[5]

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[4] MCI argues (at 13) that the local exchange carriers failed to remove enough line and trunk port costs from the local switching category in their access charge reform tariffs. However, the Commission has already resolved this issue after a full investigation of the tariffs. ***See*** Tariffs Implementing Access Charge Reform, 13 FCC Rcd 14683, ¶¶ 88-90 (1998).

[5] For these reasons, there also is no basis for including a "q" factor, either prospectively or retroactively, in the pending rulemaking proceeding to consider the level of the price cap "X-factor." ***See*** Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, Further Notice of Proposed Rulemaking, FCC 99-345 (rel. Nov. 15, 1999) ¶¶ 49-50.

AT&T also argues (at 17-20) that the Commission should adopt a "q" adjustment because the rate of return for local switching is too high. However, in its order adopting price caps, the Commission decided that it was "improper and unnecessary" to judge the performance of price cap carriers by analyzing rate of return at the access category level. ***See*** LEC Price Cap Order, 5 FCC Rcd 6786, ¶ 380 (1990). In the Access Charge Reform order, the Commission specifically rejected proposals to re-initialize the price cap indexes based on rate of return, finding that it "would have substantial pernicious effects on the efficiency objectives of our current policies." Access Charge Reform, 12 FCC Rcd 15982, ¶ 292 (1997). Moreover, MCI concedes that the Commission's own actions have inflated the apparent rate of return for local switching at the expense of other access categories. For instance, it notes that the Commission targeted X-factor reductions to the transport interconnection charge starting in 1998 that otherwise would have reduced local switching rates. This step (alone, and in combination with the other factors listed above) had the predictable effect of inflating the apparent rate of return for local switching. Consequently, it would be completely arbitrary for the Commission now to use rate of return as an excuse to reduce the price cap for the traffic sensitive basket without adjusting the effects of separations factors and without making offsetting increases in the price caps for the other baskets.

MCI argues (at 13) that the Commission's application of a single X-factor for all baskets is improper, because productivity in local switching allegedly outpaces the gains for the other access categories. However, it offers no evidence that this is so. Moreover, the Commission's X-factor is based on an analysis of total company productivity, not productivity in any particular service. ***See, e.g.***, Price Cap Performance Review for Local Exchange Carriers, 12 FCC Rcd 16642, ¶¶ 109-111 (1997) (rejecting proposals to calculate productivity solely for interstate services). Given the shared use of facilities, there is no legitimate economic basis for calculating productivity separately for a particular service. As is explained in the Taylor and Gollop analyses attached to USTA's Reply Comments, the growth in minutes-of-use for local switching is incorporated in the current X-factor. ***See*** USTA, Reply Comments of Dr. Taylor, p. 10; Frank M. Gollop, Economic Evaluation of "Q" Factor Proposed By AT&T, p. 11. Here again, the Commission could not effectively assign a higher X-factor to local switching without removing a corresponding amount of X-factor impact from the other access categories.

MCI also raises other issues that are irrelevant to local switching, such as complaints that the X-factor should be higher, and that the local exchange carriers have overstated their plant accounts. The Commission is considering these issues in other proceedings, and should not address them here. ***See*** Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, Further Notice of Proposed Rulemaking, FCC 99-345 (rel. Nov. 15, 1999); Matter of Continuing Property Records Audits, Orders, ASD File No. 99-22 (rel. Mar. 12, 1999). Moreover, updated information on productivity in the non-farm business sector, upon which both the price cap index and the X-factor are calculated, shows that the X-factor should be *reduced*, not increased. ***See*** USTA Reply Comments, Frank M. Gollop, Economic Evaluation of "Q" Factor Proposed By AT&T, pp. 9-14.

IV. The Commission Should Follow Through On Its Phased Approach For Pricing Flexibility.

Several commenters agree with Bell Atlantic that the Commission should adopt a consistent framework for pricing flexibility for switched access services by mirroring the "triggers" and regulatory relief that it adopted for the dedicated transport and special access categories. ***See, e.g.,*** USTA, 9-10; GTE, 21-22; GSA, 7-8. That is, local exchange carriers should be permitted "Phase II" relief (removal of common line and traffic sensitive services from price caps) when competitors offer such services to at least 50 percent of customer locations over their own facilities, similar to the 50 percent trigger for transport.

Other commenters, however, reveal their continuing opposition to the Commission's phased approach to pricing flexibility, arguing either that Phase II relief should not be available until a local exchange carrier actually has *lost* 50 percent of its customers to competitors (e.g., AT&T, 8-12; Time Warner, 25-26), or that there should be an outright ban on Phase II relief for the indefinite future (MCI, 7-10). The Commission should reject these self-serving and facially anticompetitive proposals. In the Order, the Commission correctly adopted a phased approach that links increasing pricing flexibility to factors that demonstrate a local exchange carrier's inability to exercise exclusionary pricing behavior. ***See*** Order, ¶¶ 77-80. Those factors were based on irreversible investments by other carriers in facilities that provide competitive alternatives. ***See*** id., ¶ 79. Such investments would ensure that a competitive alternative would be available if a local exchange carrier tried to exercise market power. In contrast, the proposals to deny the local exchange carriers additional pricing flexibility until they have lost a specific amount of market share would not protect competition – they would actually impede competition by preventing the local exchange carriers from offering customers their best prices until they had lost a specified portion of the market. By allowing new entrants to operate under a price umbrella, such a policy would deny customers the benefits of vigorous price competition, and it would shelter inefficient competitors.

The Commission's approach, which looks at the *offering* of competitive services to a significant percentage of the market in a metropolitan statistical area, properly allows increasing pricing flexibility when there is an objective demonstration that customers have competitive alternatives to the incumbent carriers' services. Unlike market share, which, by itself, is a poor indicator of future pricing behavior, the Commission's criteria directly measure the pressure that new entrants place on an incumbent's ability to control prices. ***See*** USTA Reply, Reply Comments of Dr. Taylor, p. 2. The Commission should adhere to this approach in developing a "trigger" for removing common line and traffic sensitive services from price caps based on the offering of competitive services to (1) 50 percent of customer locations; or (2) customers representing 65 percent of revenues.

V. The Commission Rely On Market Forces To Control CLEC Access Charges.

The Commission's request for comments on competitive local exchange carrier ("CLEC") access charges elicited a vigorous debate between the interexchange carriers, who complained about price-gouging by CLECs, and the CLECs, who complained that the interexchange carriers refuse to pay CLEC access charges and threaten to block calls to CLEC facilities. ***See, e.g.,*** AT&T, 27-32; Sprint, 14-28; MCI, 18-22; ALTS, 16-21; Time Warner, 19-22. The interexchange carriers argue that they have (and need) the right to refuse to interconnect with CLECs who attempt to apply excessive access charges. They claim that this would give them the ability to negotiate reasonable charges. The CLECs insist that Sections 201(a) and 251(a) of the Act require the interexchange carriers to interconnect with them, and that the "filed rate doctrine" requires the interexchange carriers to pay whatever charges are contained in the CLECs' tariffs. ***See, e.g.,*** MGC, 17-19. According to the CLECs, the interexchange carriers can file Section 208 complaints with the Commission if they believe that the CLECs' rates are excessive, but the interexchange carriers should not be allowed to exercise "self-help" by withholding payment. ***See, e.g.***, Allegiance, 2-10. Both sides portray themselves at the mercy of the other, and seek the Commission's help in enhancing their bargaining power.

The problem with the CLEC approach is that it assumes that interexchange carriers are required to pay for services that they do not order, at prices they have not agreed to pay. This creates the potential for abuse. For instance, Sprint describes CLECs that entice end users to shift their 800 calls from the incumbent local exchange carrier to the CLEC, promising them a "kick-back" of excessive access charges that the CLEC imposes on the interexchange carriers. ***See*** Sprint, 17. Such kick-backs are only possible if a CLEC can force the interexchange carrier that provides the 800 service to pay inflated rates for the CLEC's access service.

To combat such abuse, the Commission should find that the interexchange carriers do not have an unrestricted obligation to purchase access services from the

CLECs. The Commission should also find that an interexchange carrier does not have a legal obligation to pay for an access service that it has not affirmatively ordered.[6]

The Commission has never held that every interexchange carrier must interconnect with every local exchange carrier. Indeed, most interexchange carriers offer services on a regional basis or to subsets of the market, such as business customers. Section 201(a) of the Act requires a carrier to interconnect with another carrier only after a Commission hearing and order. The Commission has not elaborated upon the interconnection obligations of carriers under Section 251(a), other than to find that it applies to both dominant and non-dominant carriers. ***See*** Local Competition Order, 11 FCC Rcd 15499, ¶ 997 (1996). It did not address the simple fact that most interexchange carriers do not interconnect with all local exchange carriers.

In addition, interexchange carriers are required to pay only for the access services they order. In the Open Network Architecture proceedings, the Commission required the local exchange carriers to unbundle their access services so that the carriers would pay only for the specific access services they want to receive. ***See, e.g.,*** Amendments of Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture, 6 FCC Rcd 4524 (1991). Typically, this is done through an access service request ("ASR"), which indicates the services ordered under a local

[6] ***See*** AT&T, n.55 (absent an affirmative order from an interexchange carrier for specific switched access services, such as presubscribed traffic, "dial around" (1010XXX) calls, or 800 calls, a CLEC should not route such traffic to an interexchange carrier's network or assess access charges for such traffic).

exchange carrier's tariff. If an interexchange carrier has not ordered an access service, it does not have to pay for it, and the local exchange carrier does not have to provide it.

To ensure a balance of bargaining power between the interexchange carriers and the CLECs, the Commission should clarify the obligations of interexchange carriers to interconnect with CLECs under Sections 201(a) and 251(a) of the Act. The Commission should find that these provisions require facilities-based interexchange carriers to interconnect with the CLECs on reasonable and non-discriminatory terms. If an interexchange carrier refused to interconnect with a CLEC, the CLEC could petition the Commission under Sections 201(a) and 251(a) to order such interconnection. In such an investigation, the interexchange carrier's refusal should be presumed reasonable and non-discriminatory if the CLEC's access charges are greater than a benchmark, such as the incumbent local exchange carrier's rates, the nationwide average rate of the local exchange carriers' rates, or the NECA average schedule rate. If a CLEC's rates were higher than the benchmark, the burden would be on the CLEC to prove that the interexchange carrier's refusal to interconnect was unreasonable given all of the facts and circumstances. In contrast to the other proposals for benchmarks, the issue in this investigation would not be the reasonableness of the CLEC's rates, but the reasonableness of the interexchange carrier's decision not to interconnect.

ALTS proposes a benchmark based on the incumbent local exchange carriers' rates, but including a conversion of the PICC charge to a per-minute rate. ***See*** ALTS, 4-5, 9-15. However, this would result in a benchmark of as much as four to six cents per minute, many times higher than the incumbent local exchange carriers' per-minute rates.

See id., 10. This would make it difficult for interexchange carriers to maintain nationwide average rates, and it would undermine discount long distance rate plans that are as low as 5 cents per minute on nights and weekends. ***See*** Sprint, 16. For this reason, the benchmark for per-minute CLEC access charges should be based on the nationwide average per-minute rates, and the benchmark for any flat-rated CLEC charges should be based on the nationwide average PICC rates. The Commission should make it clear that the CLECs are free to recover any costs above the benchmarks directly from their end users. ***See*** Sprint, 21. Such recovery should be irrelevant to any investigation into the reasonableness of an interexchange carrier's refusal to interconnect with a CLEC.

Finally, as Bell Atlantic argued previously, the Commission should also adopt a rule that a CLEC cannot charge more for terminating access (or for originating 800 access) than it charges for originating access on normal toll calls. ***See*** Bell Atlantic, 26-27; ***see also*** Time Warner, 18; MCI, 21. Although this may not be a practical constraint on some CLECs that focus on 800 and terminating calls and that have little originating 1+ traffic (***see*** Sprint, 22-23), it would prevent abuse of terminating access rates for most CLECs.

VI. Conclusion.

There is no support in the industry for an order requiring capacity-based local switching rates. The Commission should adhere to its market-based approach to access charge reform and adopt rules that will promote the Act's deregulatory goals.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on this 29th day of November, 1999, copies of the foregoing Reply Comments were filed at the FCC Secretary's Office, with copies to the FCC's copy contractor, ITS.

Jennifer L. Hoh

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* Via hand delivery.